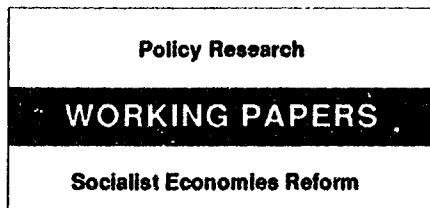


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# **Bulgaria's Evolving Legal Framework for Private Sector Development**

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The administrative and judicial machinery for implementing new laws is slower to develop than the new laws themselves. The challenge of legal development is as immense as that of economic reform — and the two are inexorably intertwined.

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This paper — a product of the Socialist Economies Reform Unit, Country Economics Department, and the Europe and Central Asia Division, Legal Department — is part of a larger effort in the Bank to study evolving legal frameworks in Eastern Europe. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact CECSE, room N6-035, extension 37188 (May 1992, 34 pages).

Bulgaria is in the midst of a historic transformation from a planned to a market economy. The Bulgarian government is working steadily to create a legal framework in which the private sector can develop. Many new laws — including a new constitution and new laws on companies, foreign investment, and competition — have been adopted over the past two years, and more are now being drafted and debated. Bulgaria's pre-war legal framework was quite modern for its time, and most of these new laws draw on pre-war Bulgarian tradition.

Gray and Ianachkov describe the current legal framework in Bulgaria in the areas of constitutional, real property, intellectual property, company, foreign investment, bankruptcy, contract, and antimonopoly law. These areas of law define property rights, the means for exchanging property rights, and the rules for competitive market behavior — the bedrock of a legal system for a market economy.

In Bulgaria as in the other countries of Central and Eastern Europe, defining real property rights and creating the conditions for free and fair competition are the most contentious and confused legal areas because they tread so heavily on vested interests. Other areas of law are less of a problem.

But the administrative and judicial machinery for implementing those laws is slower to develop. Laws by themselves are only paper; the legal framework comes to life only when legal and administrative institutions can enforce the laws and readily resolve the disputes they inevitably spur, and only when the public accepts that the laws are binding. Moreover, the laws by necessity provide only a general framework. Their content must be filled by more detailed regulations and practice in individual cases, a process that takes time. The challenge of legal development is as immense as that of economic reform, and the two are inexorably intertwined.

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Bulgaria's Evolving Legal Framework  
for Private Sector Development

Bulgaria's economy is in the midst of a historic transformation from plan to market. Stimulating the growth of a vibrant and productive private sector--through both privatization of existing public enterprises and the growth of new private companies--is one of the most important challenges Bulgaria faces in this transformation. Any economy needs "rules of the game" to function. While these rules derived primarily from the central planning bureaucracy during Bulgaria's socialist period, a private economy depends heavily on a decentralized legal system to create and enforce such rules. Thus, developing the private sector requires a sound legal framework and supporting legal institutions.

This paper describes the current legal framework in Bulgaria in several areas--including constitutional, real property, intellectual property, company, foreign investment, bankruptcy, contract, and antimonopoly law.<sup>1</sup> These areas of law serve to define (i) property rights, (ii) the means to exchange them, and (iii) the rules for competitive market behavior. In essence they form the bedrock of a legal systems for a market economy.<sup>2</sup>

Bulgaria has made impressive strides over the past two years to enact laws designed to support a market economy. There is, however, still a long way to go in formulating a comprehensive legal framework and in creating and strengthening the legal institutions needed to implement it. As in the other countries of Central and Eastern Europe (CEE), defining real property rights and creating the conditions for free and fair competition are perhaps the most contentious and confused legal areas--largely because they tread so heavily on existing vested interests. Other areas of law, including intellectual property, company, foreign investment, and contract law, are less problematic.

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<sup>1</sup> This paper is part of a larger research project sponsored by CECSE and LEGEC to study evolving legal frameworks in Eastern Europe. Other studies include Gray et.al., The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland, World Bank WPS 800; Gray et.al., Romania's Evolving Legal Framework for Private Sector Development, WPS 872; Gray and Stiblar, The Evolving Legal Framework for Private Sector Development in Slovenia, WPS forthcoming, April 1992; and Atiyas et.al., Hungarian Legal Reforms for the Private Sector.

<sup>2</sup> This paper does not discuss certain other areas of law that are also important to the private sector, including privatization, banking, taxation, and labor law. Although a critical area of reform, privatization is a transitional issue, whereas the paper seeks to address the longer-term legal structure. The other areas of law are omitted due both to space limitations and to likely coverage in other World Bank or external studies.

## Constitutional Law

### Historical Background

The Constitution of 1879. The first Bulgarian Constitution (known as the Turnovo Constitution) was adopted by the Constituent Assembly of Bulgaria in the old capital Turnovo in 1879. Although it established a constitutional monarchy, it contained many democratic principles and contributed to the creation of parliamentary institutions in the country. Private property, universal male suffrage, and separation of powers were elaborated as basic principles. The Constitution failed, however, to provide strong checks against authoritarian tendencies and was suspended twice (in 1881-1883 and in 1934-1938) and finally replaced by the first socialist Constitution in 1947.

The Constitution of 1947. The socialist Constitution of 1947 created the legal base for the transformation of Bulgaria into a one-party state with a centrally planned economy.<sup>3</sup> It granted public property extensive protection and imposed limitations on private property. Several laws adopted pursuant to the Constitution removed any remaining guarantees for private property and reclassified it as "individual property", a category reserved primarily for residential real estate. Extensive nationalization began in 1948. The collectivization of agricultural land into cooperatives, completed in the early 1950s, concluded the process of transformation of the Bulgarian economy into a centrally planned and bureaucratically regulated system.

The Constitution of 1971. In 1966, the 9th Congress of the Bulgarian Communist Party decided to draft a new Constitution to transform the state from "a State of proletarian dictatorship" into an "all-people's State." This resulted<sup>4</sup> in the Constitution of 1971--the Constitution of "mature socialism". According to Article 5, "national sovereignty, unity of power, democratic centralism, socialist democracy, legality and socialist internationalism" were the main principles of Bulgaria's political system.<sup>5</sup> The Constitution consolidated the role of the Communist Party as the guiding force in society. Although adopting some seemingly democratic provisions, the document further

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<sup>3</sup> The Bulgarian Communist Party was declared the leading force in society. All other traditional parties were dissolved, and the once powerful Bulgarian Agrarian People's Union was reduced to an "ally" of the party in the construction of socialism. The BAPU, however, participated in all post-war Bulgarian governments.

<sup>4</sup> The 12th National Assembly elected a Constitutional Commission in 1968, and a draft of the new Constitution was presented to the National Assembly on March 30, 1971. After one month of debate, the Constitution was adopted by the National Assembly on May 1, 1971 and submitted to a national referendum on May 16th. As expected, the new Constitution was approved by an overwhelming majority--officially 99.66% of all votes.

<sup>5</sup> As in most socialist constitutions, many of the Constitutional provisions lacked an exact legal meaning but were rather general political statements repeating basic Marxist theoretical concepts.

centralized state power. It established a new body, the State Council, designed to be a permanent collective head of state, presided over by the Secretary General of the Communist Party. The forty members were elected by the National Assembly and were members of the Assembly as well. The Council had broad legislative powers and could issue decrees when the Assembly was not in session--some 350 days a year! Such decrees, when endorsed by the Parliament, held the power of law. In this way the legislative process was "streamlined"; in fact, the legislative power of the National Assembly was reduced to rubber-stamping and virtually transferred to the State Council. The economic system continued to be based on the public ownership of the means of production, with the aim of preventing the "exploitation of one human being by another" and of developing the economy in a planned manner (Article 13).

### The New Constitution

The Constitution of 1971 was amended several times in 1990 and finally replaced in July 1991 after the ouster of the communist regime. The present Bulgarian Constitution<sup>6</sup> represents a radical departure from its socialist predecessors. Most socialist phraseology is gone, replaced by democratically-oriented legal principles and values. In general the new constitution provides reasonable protection for the property and economic rights of individuals and creates a favorable legal basis for the development of the private sector for the first time since the end of the World War II.

The Constitution contains 169 Articles organized in ten chapters:

- (1) General Principles;
- (2) Fundamental Rights and Obligations of the Citizens;
- (3) National Assembly;
- (4) President of the Republic;
- (5) Council of Ministers;
- (6) Judicial Power;
- (7) Local Autonomy (Self-government) and Local Administration;
- (8) Constitutional Court;
- (9) Changes and Amendments of the Constitution. Adoption of New Constitution; and
- (10) Coat of Arms, Seal, Flag, Anthem and Capital.

General Principles, Rights, and Obligations. Chapters 1 and 2 define the rights and obligations of citizens. The enumerated human rights are those accepted by most democratic societies--including equality before the law, guaranty against arbitrary arrest and imprisonment, and freedom of expression, religion, association, and movement. Private property rights are guaranteed, and private property is declared inviolable (Article 17). It may be nationalized only for state and municipal needs, only if those needs cannot be met in any other way, and only with prior and equivalent compensation. Article 19 states

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<sup>6</sup> State Gazette, No 56, July 13, 1991

that the economy of Bulgaria is based on free enterprise<sup>7</sup> and that domestic and foreign investment are to receive equivalent treatment. The law is obliged to prevent unfair competition and the abuse of monopoly power.

Article 21(1) declares land to be a basic part of the national wealth that will receive special protection from the state and society. Arable land can be used only for agricultural purposes, with conversion to nonagricultural uses only on an exceptional basis and as strictly regulated by law.<sup>8</sup> Foreigners may not own land except through inheritance (in which case the property must be subsequently transferred to Bulgarian nationals) (Article 22).<sup>9</sup> This provision could deter foreign involvement in the economy if it limits the ability of foreign lenders to take security interests in real property.<sup>10</sup>

The power to tax is more strictly limited in the new Constitution than in the old one. Article 60 obliges all citizens to the pay taxes and other fees as established by law (and only by law). Article 84(3) then states that "the National Assembly establishes the taxes and tax rates." This is an important guarantee against the liberal interpretation of similar provisions of the former Constitution, under which the Council of Ministers was authorized to grant tax exemptions and in some cases to set tax rates.

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<sup>7</sup> All mineral deposits, beaches, public roads, bodies of water, and forests and parks (including archeological sites) of national importance remain the exclusive property of the State (Article 18). Although not required, the state may establish a monopoly (with the possibility of concessions to private operators) over the railroads, the national post and telecommunication networks, nuclear energy, and the production of radioactive materials, arms and explosives, and biologically active substances.

<sup>8</sup> Special concern for land, and strict limits on conversion of agricultural land to nonagricultural uses, is typical of reforming socialist economies. See Polish Legal Framework, Romanian Legal Framework, Slovenian Legal Framework, supra note 1.

<sup>9</sup> Foreigners may acquire rights to use or build on land, and foreign nationals resident in Bulgaria may acquire residential property. Furthermore, foreign nationals who are not permanent residents in Bulgaria are able to acquire residential property if they obtain permission from the Ministry of Finance. If the residence is a house rather than an apartment, the land on which the house sits can also be acquired. Although even this limited ownership of land by foreigners would appear to contravene the Constitution, it has apparently not been contested. Foreign-owned companies registered in Bulgaria are Bulgarian legal persons and thus do not fall under the Constitutional prohibition on land ownership.

<sup>10</sup> If foreigners are not permitted to own land, foreign banks will not be able to foreclose on secured property and take possession, but will instead have to depend on local auctions (in a relatively thin market) to recover value from the security interest. In practice, foreign lenders in such an environment forego the security interest altogether and instead rely on local bank guarantees, which often in turn require explicit or implicit public guarantees.

Although reduced in scope from those in the previous Constitution, the new Constitution continues to provide certain social guarantees, including free elementary and secondary education (only in public schools) and free medical care (Articles 52 and 53).<sup>11</sup> Under certain conditions (to be elaborated in a later law) university education may also be free.<sup>12</sup> Although appealing from society's standpoint, these guarantees may prove expensive. On economic grounds, a good case can be made for some user charges, particularly for curative health care and higher education, with targetted subsidies for low-income families.<sup>13</sup>

Structure of the public sector. The old idea of unitary and indivisible power has been abandoned. Returning to the pre-war tradition, a balance of power among the unicameral Parliament (or "National Assembly"), the executive branch (or "Government"), and the judiciary is re-established as a basic principle of the Constitution. Nevertheless, the structure of the public sector is similar to that under the last version of the former Constitution, with the exception of the judicial sector, which will be radically restructured.

The National Assembly has one chamber with 240 representatives elected on a proportional basis. Although this structure is similar on paper to that of the previous socialist Assembly, the role of the new parliament is very different. During socialist times, the Assembly met only twice a year for several days, essentially to rubber-stamp the numerous decrees of the former State Council or laws prepared under the supervision of high-ranking officials of the Communist Party. In contrast, the new Assembly is a full-time institution designed to have final authority over lawmaking. Bills can be introduced by the Government or by any of the 240 members of the National Assembly.<sup>14</sup> To become law, a bill must be approved by a simple majority of those present in the National Assembly (with

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<sup>11</sup> Private alternatives in education and health care are to be regulated by the state.

<sup>12</sup> This is yet another unclear provision calling for further clarification in a separate law. Though the law on education has not yet been passed, fees are already being collected in some state and emerging private universities.

<sup>13</sup> This advice is typically given by the World Bank to developing countries, where the annual public cost of university students is on average 26 times that of primary school students, and where university students tend to be from higher-income households and are therefore more able to pay for the education. It also holds for industrialized countries, where university education is also more expensive than primary or secondary education. Bulgaria should be careful to allocate its scarce public resources to the sectors with the greatest social returns, typically primary and secondary education; selective scholarships can be granted to university students unable to pay tuition themselves.

<sup>14</sup> The only exception is the annual budget bill, which must be prepared and presented by the Government.



a required quorum of a least 120) and signed by the President.<sup>15</sup> The National Assembly must also authorize all contracts for public borrowings (Article 84) and ratify all international agreements that include financial obligations for the State (Article 85).

The functions of the President (an office introduced in March 1990) are primarily representative in nature. The President is Head of State. After consulting with parliamentary groups, he proposes as candidate for Prime-minister the person designated by the biggest parliamentary group (Article 99).<sup>16</sup> The National Assembly elects the Prime Minister and, upon his proposal, the ministers, the President of the National Bank, and the heads of other public institutions. The President also calls general elections for the National Assembly and local authorities and sets up the dates for referenda called by the Assembly.

The Council of Ministers has executive power in Bulgaria. It is responsible for public order and national security, public administration, and foreign policy (Article 105). It is also responsible for the implementation of the budget and for the management of State property. It has the right to issue decrees (Ordinances-постановления), executive orders (разпореждания) and decisions (решения), based on authority delegated by law. In the past the Council of Ministers used this delegated legislative power extensively due to the generality of many laws. A constant stream of decrees, sometimes at odds with law and often unpublished, created a very uncertain legal environment. The Government still issues many decrees and regulations, but the underlying laws tend to have more substance (thus better confining the scope of decree making authority), and regular publication is the norm.

As in other reforming socialist economies, the role of local authorities in designing and implementing local policy is expanding rapidly in Bulgaria. Formerly the municipalities were subordinated to the government and under the strong influence of local committees of the Communist Party. Their property rights were unclear; although sometimes charged with administering state property, they rarely owned property in their own name. Under the Constitution, municipalities are for the first time supposed to have clearly defined property rights and their own budgets.

The role of the judiciary. The new Constitution radically restructures the judiciary. While repeating previous provisions regarding judicial independence,<sup>17</sup> it adds some important new guarantees, including life tenure

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<sup>15</sup> The President cannot veto a bill but can return it for reconsideration within 15 days after passage. A majority vote of all representatives (at least 121 votes) is then required for the bill to become law.

<sup>16</sup> If successive candidates are unsuccessful in forming a government, the Parliament must be dissolved and new elections called within 2 months.

<sup>17</sup> Although judges were nominally independent and subordinated only to law under the previous Constitution, local party committees had decisive influence over appointment, recall, and promotion.

(after 3 years in office) and the same immunities accorded a member of the Parliament. Judges are to be appointed by the Supreme Judicial Council (Article 130), which will consist of 25 members, of which 22 will be elected (11 by the National Assembly and 11 by the judicial authorities) and 3--the Chairman of the Supreme Cassation Court, the Chairman of the Supreme Administrative Court and the Attorney General--will be members by law.

The role of judicial institutions is further strengthened by the formation of a new Constitutional Court, whose roles are to rule (upon request) on the constitutionality of new laws,<sup>18</sup> to provide binding interpretations of the Constitution, and to rule on the constitutionality of international agreements and their consistency with previous agreements. The Court has 12 members, one-third elected by the National Assembly, one third appointed by the President, and one-third elected by the general meeting of the judges of the Supreme Cassation Court and Supreme Administrative Court. Members have single 9-year terms, with one-third replaced every three years. Cases can be brought upon request of 1/5 of the members of the Parliament, the President, the Council of Ministers, the Supreme Cassation Court, the Supreme Administrative Court,<sup>19</sup> or the Attorney General. The powers of the Court may be changed only with an amendment of the Constitution. Although this is a very new institution for Bulgaria, it could grow--as it has, for example, in Hungary--to be a decisive check on the power of the executive and legislative branches of government.

#### Rights to Real Property

The reform of property rights is the most complicated legal challenge in Bulgaria. The country faces problems similar to those in other Central and Eastern European ("CEE") countries emerging from socialism. Marxist attitudes towards property, which shaped the entire economic system of every socialist state, were profoundly different from those of market economies. Reversing these attitudes and the laws and institutions that embody them is a *sine qua non* for private sector development.

#### Defining the Basic Legal Framework

Unlike other CEE countries, Bulgaria did not have a comprehensive unified Civil Code governing both property and contract relations among private individuals in the decades prior to the socialist period. Rather, individual property rights were governed by the Property Act, and contracts were governed by the Law on Obligations. Both were based loosely on German civil law, and thus both embodied the basic civil law concepts common to European capitalist systems of the period.

After World War II, Bulgaria moved quickly to strict central planning and

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<sup>18</sup> No institution had such power of judicial review before or during the socialist period.

<sup>19</sup> Other courts may not rule on the constitutionality of laws but should instead refer such questions to the Constitutional Court.

control, and--unlike Yugoslavia, Poland, or Hungary--it remained tightly centralized throughout the socialist period. In addition to adopting a new socialist constitution (with extensive provisions on property), the pre-war laws on property and obligations were explicitly abrogated in 1951 and replaced by socialist legislation in line with Marxist doctrine.<sup>20</sup> The 1951 Property Act replaced the pre-war version in defining property rights and relations of individuals. Although maintaining many civil law concepts, it also added certain new principles and provisions to fit the needs of a socialist state.

One of the unique features of socialist property law was its concept of hierarchy of property based on ownership. The two socialist Constitutions of 1949 and 1971 defined the three main categories of ownership. "Social" ownership--ownership by all the people in theory, by the state in practice--was the highest category of ownership and received special protection. Such property included virtually all urban industrial and commercial property,<sup>21</sup> mineral resources, and public utilities. Although in theory regulated by law, it tended to be managed in practice through decisions of the Council of Ministers. Because this kind of property was excluded from individual transactions under the Constitution, it was not covered by the provisions of the 1951 Property Act.

The other two forms of property were "cooperative" and "individual" property. Cooperative property included most agricultural land and was governed by the law on cooperatives. "Individual" real property was limited to one residence and one vacation house per household (but not a separate rental house, which was considered a means of production). Individual property rights and transfers were governed during the socialist period by the 1951 Law on Property.<sup>22</sup>

Because of the superiority of social property, the two socialist constitutions provided practically unrestricted rights to the State to expropriate individual property. In urban areas these right was widely used. All industrial property and much residential property was nationalized pursuant to the nationalization laws of 1947 and 1948, and small private plots of land were gradually expropriated to secure the land needed for large-scale residential

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<sup>20</sup> This contrasts with Romania, where the old Civil Code was never abrogated.

<sup>21</sup> Until 1990, the socialist Constitution did not permit individuals to own commercial property. The 1990 amendments removed this restriction.

<sup>22</sup> During the socialist period other laws suspended temporarily the application of the Property Act to particular transactions, types of property, or regions of the country. One example was the residential property law--The Property of the Citizens Act (1971)--which attempted to limit individual ownership and provide affordable housing to all through administrative means, and in effect displaced the Property Act (except in small and relatively unpopulated rural areas) for some 20 years. Widespread application of the Property Act was restored only with the 1990 partial repeal of the Property of the Citizens Act.

and public construction (and very often also for the needs of the Communist Party and other public organizations). Although the state kept firm control of commercial property, almost all residential property nationalized or later built by the state was sold to tenants at low prices in the 1950s and 1960s.

The Bulgarians moved quickly in 1990 and 1991 to change the basic legal concepts underlying property ownership. The hierarchy of property was eliminated with the amendment of the old Constitution in 1990 and the adoption of the new Constitution in 1991. As noted earlier, the new Constitution grants full and equal protection to all property regardless of ownership, and it forbids expropriation except for carefully-defined public purposes and with full and adequate compensation. The Property Act was also amended in 1990 to eliminate some of the socialist overlay added in 1951. It now refers to private property and state property, rather than individual and social property. The law reflects the basic civil law framework of its pre-war predecessor and is thus generally adequate to govern property rights and relations in the private sector. It does not adequately address, however, the entire panoply of difficult problems relating to state-owned property.

#### Eliminating the State Monopoly on Property Ownership

A major challenge in developing a market economy in Bulgaria is to eliminate the virtual monopoly of the state over commercial property that existed during the socialist period. This entails both privatizing commercial property (or "reprivatizing" it to previous owners) and developing an active rental market in property still held by the state.

Defining the public owner. Before state property can be sold or leased, one must first define the actual owner--the actual person or entity with full right of use and transfer. Yet ownership of social property was somewhat indeterminate during the socialist period. Pursuant to the Marxist doctrine of "indivisibility of ownership", neither local governments nor state-owned enterprises ("SOEs") owned the property they used, managed, or transferred; rather they had the ownership-like right of "operational management." State-owned enterprises that "operationally managed" property could in some cases lease it but could never sell it. The relevant overseeing ministries had ultimate decision-making authority with regard to such property. Municipalities had somewhat more independent authority than SOEs. Under the Property Act, the chairman of the local municipal council could transfer state-owned residential property within municipal boundaries to individuals<sup>23</sup> (at prices fixed by the Council of Ministers<sup>24</sup>).

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<sup>23</sup> Although the Property Act did not apply to property (including virtually all commercial property) used or transferred exclusively within the public sphere, it did apply to property transfers between the state and private individuals, as referred to here.

<sup>24</sup> Because of relatively low prices, the right to buy state-owned land was a highly sought-after privilege. A heavy bureaucracy existed to check whether the applicant was qualified to buy the land, and buyers often waited for years for the transaction to be concluded.

Ownership of SOE property became a major issue in 1990 as Bulgaria began its economic transition in earnest. The 1990 amendments to the 1970 Constitution removed the prohibition against individual ownership of commercial property, and Decree 56 (discussed in greater detail below) for the first time permitted SOE's to enter into joint ventures with private partners. For a brief period in 1990 and early 1991, some Bulgarian's thought that SOE's would be able on their own initiative to transfer real property to the private sector, in particular to contribute real property to a joint venture. However, the Law on the Formation of State Property Sole Proprietorship Companies of June 27, 1991 essentially barred such transfers of property by SOEs. The law gave the Council of Ministers all rights as sole owner of the SOE (as defined under the Commercial Law), including control over all real property. Although this clarification of ownership rights was an important first step in managed privatization,<sup>25</sup> it clearly slowed down the development of a private real estate market (just as it slowed the privatization process more generally).

At present all parties accept the basic principle that the Council of Ministers controls real property attached to SOEs, while municipal governments have the power to transfer other property within municipal boundaries. This means, for example, that private entrepreneurs seeking leases of commercial space generally know with whom they must negotiate. However, there is still considerable uncertainty about the exact powers of municipalities with respect to the property they control--including what property they actually own (rather than just administer) and who sets sale prices and is entitled to sale proceeds. These issues are now being debated and negotiated in the political arena.

Reprivatizing urban property. The issue of restitution of previously-nationalized property is the subject of intense debate in Bulgaria, as in all other CEE countries. In December, 1991, Parliament took a first, limited move by passing a law providing for the restitution of certain small shops and other business premises. Specifically, under this law former owners will be able to reclaim all business premises bought by the State at artificially low prices pursuant to Ordinance #60 (1975) of the Council of Ministers. Because the number of such properties is relatively small, this law is not expected to cause extensive uncertainty and disruption in property markets.

Restitution of residential property nationalized after the war is more difficult, because most such property was subsequently sold to new tenants in the 1950s and 1960s. Former owners of residential property that remained unchanged and in state hands will be able to claim restitution under the Restitution of Nationalized Real Property Law, passed by the Parliament on February 5, 1992. Former owners whose property was subsequently sold to private parties or changed in other ways are entitled to alternative compensation, to be specified in a later law.

Another restitution law was also passed on February 5th--the law for

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<sup>25</sup> The law was in fact intended to curb the process of "spontaneous privatization"--pursuant to which SOE managers could sell SOE assets to private firms they controlled at artificially low prices--and replace it with more managed "top-down" privatization.

"Restitution of Property Rights over Property Alienated Pursuant to the Urban Regulation Law, the Planned Urban Construction Law, the Urban Development Law, the State-Owned Real Estate Law, and the Property Law." Its purpose is to return to former owners real property that was expropriated for development purposes by the state, provided that the property (if a building) still exists or (if a plot of land) is suitable for single home construction.

Restitution of large, industrial properties is not as big an issue in Bulgaria as it is in East Germany or Czechoslovakia, for example, because Bulgaria's economy was primarily agrarian before World War II. The intention of the Bulgarians is to treat those industrial properties that were nationalized the same as urban property, in essence returning them to former owners (either legal persons, if they still exist,<sup>26</sup> or their former partners or shareholders). Such solution, however, makes little sense given the enormous changes that are sure to have occurred in the business over the past 40 years. Some kind of monetary compensation would appear to be more reasonable.

Reprivatizing agricultural land. Because of its traditionally heavy reliance on agriculture, land was always considered the most important means of production in Bulgaria. Land was never extensively nationalized as it was in the Soviet Union, although large farms were confiscated in 1946-47, broken up into smaller plots, and returned to the peasants. Rather than set up state farms, the state pressured farmers to contribute their land to cooperative<sup>27</sup> farms, and they gradually lost contact with the property. Massive migration to the cities resulted in further loss of attachment to the land. Though many former owners preserved their titles to land, the registration system lost its importance and fell into disuse.

Former land owners in every CEE country have been pressing the state for restitution of agricultural land, and Bulgaria is no exception. On March 4, 1991, the General Assembly passed the Ownership and Use of Farm Land Act. The law seeks to return land to those farmers (or their heirs) who owned it just after the post-war agrarian reform. Farmers who never owned land before are also eligible to receive it. Each household is limited to 20 hectares (approximately 50 acres), or 30 hectares (approximately 75 acres) in certain areas of "intensive land use."<sup>28</sup> In an attempt to prevent land speculation, the law prohibits

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<sup>26</sup> Former legal entities are unlikely to still exist except in the case of some religious and political organizations.

<sup>27</sup> The Bulgarian cooperative movement had a strong and well-developed tradition even before the war. After the war, however, collectivization was very often forced, and cooperatives became increasingly inefficient--overburdened by bureaucracy and centralization.

<sup>28</sup> These limits reflect the limits applied in the 1947 agrarian reform. "Intensive land use" is not defined, but specific areas are likely to be designated as was done in the agrarian reform law (The Earned Land Property Act of March 9, 1946). It is unclear whether a household can subsequently acquire and own more land than the limits set in this law.

recipients from transferring their plots again for three years.<sup>29</sup> The restitution is to be carried out by the National Land Board and 269 local land boards. The period for submission of claims is one year from the passage of the law, although that term would be extended to 15 months under a draft amendment now being considered by the National Assembly. By the end of January 1992, some 512,000 claims had been submitted for the 1.42 million hectares of land available for distribution--an average of about 2.8 hectares (or 6.8 acres) per household.<sup>30</sup>

Although they are just beginning, the land boards are already facing many problems in implementing the law. Proving former ownership can often be difficult, particularly for former owners who have lost old titles. Because of the mergers of cooperatives (especially after 1971) and the neglected registration system, borders of rural property are often unclear. Finally, some observers fear that important vested interests in the existing cooperative system may attempt to block the reform. The Government has introduced amendments that would speed up the restitution process and abolish limits on land holdings in the future.

There is also concern for agricultural efficiency, especially in the case of crops that cannot be grown efficiently on small plots. Rather than try to preserve large farming units, however, Bulgarian policy makers are depending on the voluntary re-creation of cooperatives in the old Bulgarian tradition but in a form that is acceptable to the new private farmers now emerging.

#### Revising the Regulatory Framework

Land use. As in most other CEE countries,<sup>31</sup> Bulgaria's static land use planning and large-panel construction methods resulted in highly inefficient pattern of urban land use. Clusters of high-rise residential units tended to be separated from the urban core, resulting in high infrastructure and transport costs. In the absence of market signals, the government often converted good agricultural land to industrial use rather than utilize lower-quality land within a municipality. The development of a private market in land and buildings will slowly help to correct these inefficiencies in land use, if accompanied by more dynamic and generally less restrictive zoning rules. The large fines now applied on the conversion of agricultural land to other uses should be phased out as market mechanisms and complementary zoning regulations develop.

Registration. The system for registering individual real property was never interrupted during the socialist period and continues to work quite well. There was, and still is, a strong personal interest in recording all transactions dealing with private property (mainly residential buildings), and the system--

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<sup>29</sup> These limits on transfer may be abolished by amendments now being considered in Parliament.

<sup>30</sup> Bulgarian Economic Review, Vol. 1, No. 3, February 11, 1992.

<sup>31</sup> See, for example, Polish Legal Framework, Romanian Legal Framework, and Hungarian Legal Framework, *supra* note 1.

computerized in the mid-1980s--is relatively efficient and accurate in this private sphere. However, due to lack of serious incentive, transfers of state-owned property were not always recorded. As noted earlier, registration is in particular disarray in rural areas, where state-controlled cooperatives were often merged and reorganized during the socialist period. As land and buildings are privatized, incentives should reemerge for careful registration of ownership in both urban and rural areas.

Mortgage Lending. Mortgage lending has long been common in Bulgaria.<sup>32</sup> Lending conditions under socialism were not, however, those likely to prevail under capitalism, and the transition to a new system will be difficult. During the socialist period, housing was very inexpensive due to controlled prices and subsidized interest rates, and the debt burden of mortgages was therefore relatively easy for families to bear. Furthermore, because both banks and employers were state-owned companies, banks could readily garnish wages to satisfy overdue mortgage payments or, as a last resort, could expect to be subsidized by central authorities if nonpayments cut into bank profits. Eviction was possible but rare, both because of these alternative avenues for bank collection and because of the paternalistic attitude of the state. To evict an owner, a bank would had to follow long drawn-out procedures, and the state generally had to find alternative housing.<sup>33</sup> Homelessness was not a socially-acceptable outcome.

A private market economy has very different features from that described above. Market-determined housing costs are likely to be much higher, creating more of a burden on households and thus greater likelihood of default. Private banks will not be readily able to garnish wages (particularly wages paid by

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<sup>32</sup> Unlike some other socialist economies, Bulgaria has long had the concept of individually-owned units in multi-family buildings--i.e. the concept of condominium (although not with that specific name). [cite] Defining the unit for mortgage purposes was therefore not a problem as it could be, for example, in the case of cooperative housing.

Cooperatives were more common in building construction than in ownership. In the 1950s Bulgaria developed a specific form of housing construction--the Residential Construction Cooperatives (ЖКК). The idea of the cooperatives was to engage the efforts of future owners in the construction of multi-family housing and to make them responsible for the final works, the landscaping, and the maintenance. This form was widely used, but construction was hindered by the lack of materials, restrictions on the use of hired labor, underdeveloped systems of contracting, and costs well above official calculations (the latter based on fixed state prices). The cooperatives were usually built on land expropriated by the State and allotted to the cooperative. The former owners were compensated with apartments in the new building. The members of the cooperative acquired rights to the building, but the land remained state-owned. When construction was completed, the cooperative was dissolved and the participants became owners of individual apartments.

<sup>33</sup> This obligation to find alternative housing also applied to evicted renters pursuant to the Law on Rent.



private employers) to satisfy debts, and they will not be able to count on state bail-outs on bad debts. Foreclosure on the property--and thus the possibility of eviction--will become a necessity if truly private mortgage lending is to emerge. This will clearly take a major change in attitude as well as a rethinking of the legal framework for eviction and foreclosure.

### Rights to Intellectual Property

The protection of intellectual property in CEE economies is a controversial subject. While supporters argue that intellectual property protection helps spur domestic invention and creation and attract foreign investment, their opponents argue that intellectual property protection is essentially a one-way street--that it protects industrialized countries (where most inventions and creations originate) at the expense of countries who must import most technology. The most contentious areas tend to be patents for pharmaceuticals and copyrights for computer software and books. All three products are relatively easily copied and are crucial for economic development.

Despite the debate on intellectual property protection, many economies in transition from socialism--including Bulgaria--are moving to adopt western-style intellectual property laws.<sup>34</sup> An important recent development in Bulgaria is the signing of the Trade Agreement with the United States, which obliges Bulgaria to enact the modern legislation with full protection of intellectual property.

### Patents

During the socialist period, patent law had little meaning in Bulgaria's domestic economy. State control over the economy was pervasive, and inventors worked within the state apparatus. The basic framework for patent rights was provided by the Law on Inventions and Innovations of October 18, 1968. This law was firmly based on socialist principles and was thus strongly oriented towards the protection of the rights of the state. For a large category of products,<sup>35</sup> inventors--generally employees within state-owned enterprises--were given credit for their inventions in the form of "authorship certificates," which were one-time cash awards calculated generally as a percentage of the "economic effect", or savings achieved by the design or a percentage of the net return on the

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<sup>34</sup> In some cases this is being done under threat of retaliatory practices from industrialized countries.

<sup>35</sup> All chemical substances, all substances used for pharmaceutical purposes, for food and in cosmetics (obtained by chemical or non-chemical methods), all methods used for medical purposes, the new varieties of crops or new breeds of animals, technical solutions to problems related to nuclear technologies, and all inventions made as part of the work assignment by a "socialist organization" or related to the defence or the security of the country (Article 14).

invention.<sup>36</sup> These awards were typically quite small, providing little incentive for inventive behavior. Patents could in principle be obtained by the socialist organization with whom the inventor worked, but in practice domestic patents were rare.<sup>37</sup> Patents could also be obtained to protect Bulgarian inventions abroad,<sup>38</sup> even if only an "authorship certificate" had been issued in the country.

Foreigners have always been able to register patents in Bulgaria. In 1923 Bulgaria signed the Paris Convention for the Protection of Industrial Property (1883), which is the major international treaty protecting patents and trademarks. The two most important rights granted by the treaty are national treatment of foreigners and right of priority in registration. The right to national treatment obligates countries to treat foreigners as they would their own nationals under their own laws. The right of priority gives the holder of a patent one year (six months in the case of trademarks) to file in other member countries without losing priority rights over other potential claimants to the invention. However, the criteria for patentability is still a question of domestic law. Thus, the Paris Convention would do little to protect patents without a Bulgarian law that provided reliable substantive patent rights. The Convention does provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks, apparently without requiring that the mark be registered in other member countries.

This 1968 patent law is still in force today, although many of its

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<sup>36</sup> The enterprise was obliged to implement the invention and pay 50 percent of the remuneration not later than two months after the beginning of the implementation. The balance of the remuneration was due after one year and was supposed to correspond to the actual "economic effect". Litigation between the enterprise and the inventor concerning the amount of such effect was not uncommon.

<sup>37</sup> Although hardly ever used in practice, the 1968 law allowed the state's patent office to issue a compulsory license to third parties with compensation if a patent registered in Bulgaria had been unjustifiably unutilized or underutilized for three years following the publication date of the patent or four years from the day of filing the patent application (Article 37). The concept of compulsory licenses is well-known throughout the world. The Paris Convention, discussed below, allows for the issuance of compulsory licenses (Art. 5 lit. A), and the patent laws of many countries provide for them. The policy behind compulsory licensing is that countries granting monopoly rights in intellectual property deserve something in return, namely, use of those inventions. Practically speaking, however, compulsory licenses are often ineffective without the cooperation of the patentee, due to the necessary technological know-how in the possession of the patentee. Furthermore, in many cases there may be no third party interested in obtaining a license to the patent.

<sup>38</sup> Bulgarian nationals were able to obtain patents abroad only through the Institute for Inventions and Innovations. The use of the foreign exchange acquired from foreign licensing of the patent was subjected to further bureaucratic regulation (Article 46).

provisions are no longer used. The existing framework clearly needs adjustment to fit the needs of a private market economy. A new Patent Law that provides patent protection more similar to that in industrialized countries was submitted to the National Assembly in early December. Enforcement and dispute resolution procedures must also be developed for any new law to have a meaningful effect in practice. There is virtually no experience with the enforcement of private patents, which will be the major challenge of Bulgaria's intellectual property regime as it moves to a market economy.

### Trademarks and Industrial Designs

Bulgarian trademarks and industrial designs are protected by the Law on Trade Marks and Industrial Designs from 1967. The law is also one of the first in Central and Eastern Europe to protect appellations of origin, which is important for many Bulgarian agricultural products, especially the quality wines. Under the law, trademark protection lasts for 10 years and is renewable (Article 19). The right of exclusive use of an industrial design lasts for five years (Article 29). Trademarks are protected upon registration at the Institute of Inventions and Innovations. Limited protection is also available for non-registered trade marks with common and long standing usage; If someone else tries to register the same or essentially similar mark, the prior user may apply for registration of the mark within three months. The trademark law, in contrast to the patent law, does not appear to need major overhaul.

Bulgaria is also signatory to the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967). The Madrid Agreement protects both trademarks and service marks by allowing members of signatory countries to register their trademarks with the International Bureau of the World Intellectual Property Organization (WIPO) in Geneva. The mark must first be registered in the country of origin, whose administration applies for registration with WIPO. The effect of WIPO is that the trademark is protected in all signatory countries. Upon notification of the registration of a trademark, national administrations may still be authorized by national law to declare that certain trademark protection cannot be granted in that territory. Thus, like the Paris Convention, the Madrid Agreement depends ultimately on domestic law in protecting substantive rights.

### Copyright

The Copyright Law is one of the oldest Bulgarian laws in force. It covers works of literature, science and art that are the product of creative activity and are published or expressed in any form. Protection does not depend on "aesthetic content" or originality.<sup>39</sup> This wide definition makes the law potentially applicable to certain commercial products, including computer software.

Protection grants the owner the right of public recognition (Article 3), the right to publish the work and to authorize the translation and publication

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<sup>39</sup> See Eric S. Schwartz, Recent Developments in the Copyright Regimes of the Soviet Union and Eastern Europe, 38 J. Copyright Society 123-133 (1991).

in other languages (Article 4). Protection lasts for the life of the author and for fifty years after his or her death. The copyright passes to the heirs by law, or to heirs designated by the will of the author. If there are no heirs left, the copyright passes to the State (Article 18).

On the international front, Bulgaria is a signatory to the Berne Convention (Paris text of 1971), which protects literary, scientific, and artistic works for 50 years. The convention traditionally includes computer software, which is the most controversial subject of international copyright protection.<sup>40</sup> Under Berne, no formalities are required to protect a work in other member countries. Whereas in the country of origin protection may depend on registration, no central registration exists for international protection; upon creation, works are protected.

### Implementation

Enforcement capacity is an issue in all of the areas of intellectual property law discussed above. Although a registration procedure exists, can a holder of intellectual property rights actually protect these rights if another person infringes them?

The enforcement capacity of the existing Bulgarian agencies varies for the different areas of intellectual property. While copyright has been successfully protected for some time, the lack of experience in dealing with patent or trademark protection over the last 40 years makes those areas more problematic. Trademark infringements are growing daily, but little action is being taken despite the existence of the appropriate provisions in the Criminal Code. Very few lawyers specialize in protection of intellectual property outside of the few state institutions active predominately in the protection of copyrights. Enforcement will emerge as a critical issue as the private sector and foreign investment grow. Giving true meaning to these rights will require institutional strengthening in the registration agencies and the courts to insure that infringements can be identified, halted, and punished as appropriate.

## Company Law

### Historical Development

The first Bulgarian company law was the Commercial Law of May 29, 1997. It was based on German Commercial Law but also borrowed from other continental legal systems. It was amended several times before 1946, and related laws were passed--including the Law on Limited Liability Companies (1929), the Law on the Cooperatives (1907), and the Law on the Stock Exchange (1912 and 1928).

In 1951 all commercial laws in Bulgaria were abolished and replaced by a legal system designed to meet the needs of a centrally planned economy. For the

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<sup>40</sup> It is worth noting, however, that Berne allows countries to deny protection of certain works through domestic legislation, even if they are covered by Berne.

next four decades, the activity of Bulgarian enterprises was regulated through constantly changing (and sometimes contradictory) decrees of the Council of Ministers. Market-oriented commercial law ceased to be taught at the only law school in Bulgaria--the University of Sofia. Only a few Bulgarian lawyers maintained exposure to market-oriented commercial principles while working for foreign trade companies or the few companies with Bulgarian participation registered abroad. A few joint-stock companies continued to be formed by decree of the Council of Ministers, but in practice they operated like other state-owned enterprises. Several companies with foreign participation were formed under State Council decree 535/1980, but their activity was very limited.

#### Decree 56 of 1989

The State Council's issuance of Decree 56 in January 1989 was a watershed event in Bulgaria's transition to a market economy, even though at the time it was issued the move to a market economy was not a clearly-defined goal. Decree 56 represented Bulgaria's first attempt to restructure and decentralize the management of state enterprises,<sup>41</sup> as well as its first move to allow private investment in commercial activities. Decree 56 re-established most forms of companies that existed in the prewar Commercial Law, including the joint stock company, the limited liability company, and the "unlimited liability firm" (similar to a limited partnership).<sup>42</sup> State-owned firms were supposed to reorganize into joint stock or limited liability companies. Private and foreign investment could be structured as of these more formal entities or more informally as "individual", "collective", or "partnership" "firms of citizens".<sup>43</sup> The first version of the Decree restricted the rights of private companies to participate in foreign trade or to hire workers, but these restrictions were subsequently removed.

Decree 56 succeeded in decentralizing some decision making within state enterprises and in stimulating the beginnings of private entrepreneurship in the economy.<sup>44</sup> However, it had many shortcomings. First, its philosophy was somewhat schizophrenic, in that it attempted to combine continuing state control with economic liberalization and private entrepreneurship.<sup>45</sup> Second, it was too

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<sup>41</sup> An earlier, unsuccessful attempt was made in 1987-88 to transfer state enterprise property to employees.

<sup>42</sup> General partnerships could be formed under the Law on Obligations and Contracts.

<sup>43</sup> Of these only the partnership firm of citizens was a registered and taxable legal entity. The individual firm was essentially a sole proprietorship and the collective firm was essentially a "pass-through" general partnership.

<sup>44</sup> It was accompanied by other reforms to the same end, including a reduction in central price controls and revisions in tax and accounting rules.

<sup>45</sup> Unlike in some other CEE countries, economic reform to some degree preceded political reform in Bulgaria. The desire to maintain central power reflects the fact that the communist government was still in firm control when

broad and thus too general, designed as a comprehensive business code and thus covering not only company formation and liquidation but also taxation, bankruptcy, foreign investment, and even currency regulation and social security. A document of 126 Articles and about 30 pages was clearly too short and too general to cover these complex areas adequately. Subsequent implementing regulations issued by the Council of Ministers also failed to clarify outstanding issues.

### The Commercial Law of 1991

The new Bulgarian Commercial Law<sup>46</sup> was the first post-war law drafted by a team of Bulgarian lawyers in line with prewar legal tradition, and in general it is fully satisfactory for the needs of a market economy. While following in general the pre-war law, an attempt was made to introduce post-war company law concepts from western Europe. These concepts aim primarily for flexibility--for example, flexibility in establishing managing bodies, in assigning voting rights, and in converting bonds into shares in joint-stock companies. Most provisions concerning Articles of Association are optional and may be changed by the partners. At the same time, care is taken to protect various interests, especially small investors and creditors.

The law recognizes the five types of companies that are common in European civil law jurisdictions.<sup>47</sup> The joint-stock company (JSC) resembles the French S.A., the German AG, and the Anglo-American public corporation. The limited liability company (LLC) is similar to the French S.A.R.L and the German GmbH, and to some extent<sup>48</sup> to the private (closed) corporation under Anglo-American law. These two are the investment vehicles most likely to be used by the majority of medium and large investors. In addition, limited partnerships (equivalent to the German "Kommanditengesellschaft" or the French "societe commandite") or partnerships limited by shares ("societe commandite par action" or "KG mit Actionen") may be formed for specific purposes as described below. Small businesses may operate through general partnerships. Another law, the Law on Obligations and Contracts, provides the traditional form of the civil partnership, which has no legal personality.

Characteristics of the Joint-Stock Company. At least two founders are necessary to set up a JSC (or one if the State is a founder) (Articles 61, 63, 159). Capital requirements are high relative to those in other CEE countries. Minimal capital of BGL (Bulgarian Lev) 1 million (about \$50,000) is required, or

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Decree 56 was passed.

<sup>46</sup> State Gazette No. 48, June 18, 1991, in effect from July 1, 1991.

<sup>47</sup> The Trade Act regulates all companies (дружество) with "legal personality." These include the general partnership, the limited partnership, and the limited partnership with shares, which in Bulgaria (unlike in some other jurisdictions such as the U.S.) are taxable legal entities.

<sup>48</sup> The civil law forms do not, however, have the pass-through tax advantages of the American Subchapter S corporation.

5 million (approximately \$250,000) if raised by public offering.<sup>49</sup> This may include the value of in-kind contributions, as evaluated by three experts appointed by the Court upon request of the founders and contributors (Article 72).<sup>50</sup> The entire capital of the company must be subscribed, but only 25% must be contributed prior to the registration (Article 174). Capital can be increased by issuing new shares, by appreciation of the nominal value of shares already issued, by conversion of convertible bonds into shares (Article 192), or by partial capitalization of profits upon a decision of the general meeting of shareholders (Article 197). Bonds (including convertible bonds if so provided by the Articles of Association) may be issued, but their value may not exceed 50 percent of deposited capital.

Reporting requirements are designed to promote transparency and the flow of information to shareholders and creditors. Financial data on the company must be included in the Articles of Association and made available to the court prior to registration. They must also be entered in the Commercial Register and published (Article 174). Raising capital through public subscription requires a detailed prospectus.

The law provides great flexibility in assigning shareholders' rights. Both registered and bearer shares are allowed and may be exchanged for one another. Shares are transferable, but the articles of association may impose conditions on the transfer of registered shares besides the entry into the share register (Article 185). Shareholders are entitled to dividends and liquidation proceeds in proportion to their capital contributions. Interest bearing shares are not allowed. A share entitles the shareholder to one vote in the appropriate meetings (Article 181), although shares with special voting rights can be issued if so provided by the Articles of Association. Preferred shares entitled to guaranteed or additional dividends or liquidation proceeds are also allowed (Article 182). The Articles of Association may provide that such shares will be non-voting.<sup>51</sup> Shares with equal rights form a separate class, and restrictions of the rights of such class may only be taken with the consent of the meeting of this class of shareholders (with at least 50 percent of the shares represented and at least three-fourths consent of those represented).

The system of corporate governance is similarly very flexible, allowing either one-tier (Board of Directors only) or two-tier (Board of Directors and

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<sup>49</sup> For banking and insurance companies the minimal capital is BGL 10 million.

<sup>50</sup> A subscriber who does not accept the evaluation is free to contribute in cash or withdraw from the company. Although this procedure is designed to protect outside creditors from overvaluation of in-kind contributions, it is somewhat cumbersome and does restrict the negotiating freedom of the investing parties.

<sup>51</sup> If a dividend is not paid to them for two consecutive years, non-voting shares acquire the right to vote until the dividend is paid (Article 182 para 3).

Supervisory Board) systems.<sup>32</sup> The former is likely to be more appropriate for companies with fewer shareholders who can readily oversee management, while the latter may be preferable for companies with a larger number of shareholders. In the latter case the supervisory board is supposed to provide an additional check on management without being involved directly in management decisions.

Characteristics of a Limited Liability Company. The limited liability company is an intermediate form, designed to avoid the cumbersome procedures and public disclosure requirements of a joint-stock company and the unlimited joint and several liability of the partners in a general partnership. It was introduced for the first time in Bulgaria in 1924 and was popular among small and medium-sized companies during the prewar period because it provided flexibility while reinforcing strong personal contacts between the partners. The number of limited liability companies already formed under the new Commercial Law suggests that it will again be a very popular company form.

The limited liability company can be formed by one or more persons (Article 113). There is no maximum number of partners as in some other countries. Minimum capital of BGL 50,000 (about US\$2,500) is required. Rules are very flexible. The partners are free to negotiate the distribution of voting rights and profits, the quorum needed for the general meeting, and the majority vote required for particular decisions. The share of the partner in the company is proportional to his contribution, but this provision can also be changed (Article 127). At the moment of registration only 70 percent of the capital must be effectively contributed, with some partners contributing as little as one-third (Article 119). While not reducing the liability of partners in the longer-run, this flexibility can relieve financial pressure in the short term. The articles of association can then establish under what conditions the capital of the company will be called up (Article 115 para 4).

Shares are freely transferable among partners. However, transfers to third persons are conditional on approval at the general meeting. Such limitation on outside transfer, designed to preserve strong personal links among the partners, is one of the basic features of the European LLC. The number of the partners in the company is not limited.

Characteristics of the four partnership forms. Four partnership forms currently exist under Bulgarian law--the general partnership, the limited partnership, the limited partnership divided by shares, and the "civil" partnership.<sup>33</sup> The first three are governed by the Commercial Law and the last by the Law on Obligations and Contracts. Two major differences among the four forms concern taxation and liability. The three forms governed by the Commercial

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<sup>32</sup> In the former the general meeting of shareholders elects the directors, while in the latter the general meeting elects the supervisors, who in turn elect the directors. One person cannot be both a director and a supervisor.

<sup>33</sup> Although widely used in Bulgaria, the term "civil partnership" is imprecise, because these entities can also engage in commercial activity.



Law are considered taxable legal entities, while the civil partnership is not.<sup>54</sup> With respect to liability, all partners in the general and civil partnerships--but only the general partners in the limited liability forms--have unlimited joint and several liability. The liability of the rest of the partners in the limited forms is limited to the amount of their agreed contribution (Article 99). The limited partnership divided by shares, like the joint-stock company, can raise capital through public offerings and is subject to the same requirements in so doing.

#### Procedures for Establishing a Company

Establishing a company is relatively easy in Bulgaria from a legal perspective. Prior to registration, the founders of a company must draft the Articles of Association, the first general meeting of shareholders must approve the Articles, the management must be appointed, and the minimal capital contribution must be made. The Articles of a JSC or LLC need not be approved by a notary as in many other European countries,<sup>55</sup> although partnership deeds require notarial approval. The founders then apply to the relevant district court for approval of the Articles and for registration in the Commercial Register. The company is deemed incorporated as of the day it is entered in the Register. Upon approval by the court, the decision must be published in the Official Gazette and the company must register with the tax authorities.

The process is complicated not by the provisions of the law, which are simple and relatively inexpensive, but by the lack of experience and capacity in the courts of registration to handle the growing number of applications. Technical assistance and improved automation could help improve the efficiency and speed up the registration process.<sup>56</sup>

#### Foreign Investment

On January 16, 1992, the National Assembly passed a new foreign investment law--the Law on the Business Activity of Foreign Persons and the Protection of Foreign Investment. The new Government, formed after the elections in October, had declared that removing obstacles to foreign investment would be a top legislative priority.<sup>57</sup> The new law is extremely liberal, imposing almost no constraints and offering generous incentives for foreign investment.

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<sup>54</sup> While not very flexible, the civil partnership is sometimes used by foreign investors because of its favorable tax consequences.

<sup>55</sup> See, for example, Polish Legal Framework and Romanian Legal Framework, *supra* note 1.

<sup>56</sup> Romania, for example, has established an automated system for company registration.

<sup>57</sup> The new law replaced the previous foreign investment law, which had only been in force for 6 months. The old law was quite restrictive in comparison to similar laws in other CEE countries.

### Forms of Investment

Unlike its predecessor, the applicability of the new law is reasonably clear. Non-residents, excluding Bulgarian nationals, are considered foreigners for purposes of the law. Resident foreign nationals are not considered foreigners and have unconditional national treatment. Bulgarian nationals with a second dual nationality who are resident abroad may choose how to be treated for purposes of the law (Article 2, para 2). Foreign-owned companies set up and registered in Bulgaria are Bulgarian legal persons and are not considered foreigners.

Forms of investment are governed by domestic law. Foreign investment can be organized in any of the forms recognized in the Commercial Law (as discussed above) or as a civil partnership under the Law on Obligations and Contracts. In addition, foreign persons and partnerships without legal personality can be recognized in Bulgaria for purposes of the Commercial Law if registered in their country of residence (Article 3, para 6). The share of foreign ownership is not limited. Foreigners can participate in joint ventures with Bulgarian entities or can operate through wholly-owned entities. Foreign companies can also set up branches in Bulgaria.

No investment approval is needed except in a few areas (as specified in a negative list).<sup>58</sup> The abolition of the complicated and unclear approval procedures of the former law is one of the most important features of the new one.

### Rights and Guarantees

Foreigners receive national treatment in all areas except land ownership. No foreigner may own land (Article 5, para 2), and no domestic company with more than 50% foreign participation may own arable land. Foreigners may, however, own buildings and acquire rights (including long-term leases) over land if needed for business activity.<sup>59</sup> Foreigners may own residential property with a "construction right" on the underlying land.<sup>60</sup>

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<sup>58</sup> Article 5 (Restrictions). Most of the areas on the negative list are "sensitive" industries for which licenses are also required of domestic investors. These include the manufacture and trade of arms, ammunition and military equipment; banking and insurance, including the acquisition of shares in banking or insurance companies; and exploration and exploitation of natural resources in the territorial sea, the continental shelf, or the exclusive economic zone.

<sup>59</sup> Foreign persons or foreign-controlled companies may not acquire real property in some regions of the country, as designated by the Council of Ministers (Article 5, para 3).

<sup>60</sup> Such "construction right" is typically granted to owners of apartments in buildings built on state-owned land. It provides that such land cannot be expropriated without regard to the building on it.

The law guarantees full repatriation of profits (in domestic or foreign currency), foreign debt service payments, and other proceeds (including liquidation or sale proceeds) from the investment (Article 13).

In line with Constitutional guarantees, the law allows expropriation only for important public needs that cannot otherwise be met (Article 10). Any expropriation must be authorized by the Minister of Finance, and prior compensation is required, either in-kind or (upon the consent of the foreigner) in money (Article 10, para 7). Expropriation decisions can be contested in the Supreme Court.

### Tax Incentives

Tax incentives are covered not by the foreign investment law but by Decree 56.<sup>61</sup> This decree provides, among other things, five-year tax holidays for companies with foreign participation that operate in high-technology industries, agriculture, food-processing and tourism, as well as companies with foreign participation operating in free-trade zones.<sup>62</sup> Because the government has not provided a specific list of "high-tech" sectors, the incentives are in practice available to most if not all investors. The same tax incentives are not, however, available to domestic investors, even if they operated in the same kind of business. Custom regulations provide for exemption from custom duties of imports to be used for export-targeted production as well as relatively low duties on imports to be used for investment. In general these customs regulations apply equally to foreign and domestic investors.

Discrimination against domestic investment is only one of the problems with tax incentives for foreign investment in Bulgaria and elsewhere.<sup>63</sup> Tax incentives--holidays, in particular--can cause tremendous revenue loss and can wreak havoc in tax administration. Foreign firms know countless ways to shift income into and expenses out of the tax holiday period, thereby effectively stretching out the tax holiday period and the corresponding revenue loss, often for many years. Because tax authorities tend to ignore firms in holiday periods, they do not build up the records and firm history needed to tax these firms effectively when the holidays expire. And with all of these costs it is not clear that holidays do much on the margin to attract foreign investment. Firms look most for stability and potential markets. Above all, they want to avoid major losses, and holidays do nothing to further that goal; firms that succeed in making profits are often not so adverse to paying moderate taxes (particularly if they are from countries with foreign tax credit systems that would otherwise tax them at home, albeit perhaps with some deferral). Of course, firms will take anything that is offered. Bulgaria can hardly afford significant revenue

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<sup>61</sup> Decree 56 will continue to govern taxation until new tax laws are introduced, perhaps later in 1992.

<sup>62</sup> The companies operating in free trade zones were to be subject to a 20 percent rate of tax after the expiry of the holiday period.

<sup>63</sup> Most CEE countries offer similar tax holidays and other incentives to foreign investors.

give-aways at this important period in its stabilization efforts, nor can it afford to complicate the already daunting task of developing a competent and modern tax administration. It should open its doors to foreign investors but provide no better or no worse than national treatment--including a moderate level of taxation.

### Contract Law

#### Features of Socialist Contract Law

Three major characteristics distinguished Bulgarian contract law from its pre-war predecessor. First, contracts among private parties were treated differently than contracts among state enterprises. The Bulgarian contract law applicable to the limited (generally non-commercial) sphere open to private sector transactions was the Law on Obligations and Contracts of 1950. The law in theory applied to socialized enterprises, but in practice contracts among such enterprises tended to be governed by separate legislation or by administrative orders and decrees of the Council of Ministers. Although the law contained extensive socialist phraseology and certain uniquely socialist principles (especially with regard to the priority of the plan, as described below), it reflected many legal principles common to continental European legal systems.

Second, the idea of contractual freedom (though proclaimed in theory) was in practice subordinated to the needs of the central plan. The plan was adopted annually and had the force of law. Every other related law was drafted in such way that the priority of the plan over individual contracts was assured. There was even a specific category of "pre-contractual" disputes in which the subject matter was not the fulfillment or breach of contract but the very willingness of one of the parties to conclude the contract. Virtually the only way for a party not to conclude such a contract was to prove that the production capacity to fulfill it was not available. Though no longer used in practice, such category of disputes is still reflected in the Law on Obligations and Contracts.

Third, socialist ideology dominated contract law. Contracts that were consistent with the law but considered inconsistent with the "rules of socialist co-existence" could be nullified.

#### The Current Situation

Although the central planning agency was closed and central planning abolished in 1990, no changes were made in the Law on Obligations and Contracts, which is now the only functioning contract law in the country. The law still formally distinguishes between contracts among individuals and contracts among socialized enterprises, but all current transactions are regulated by the general provisions applicable for individuals.

As noted earlier, this law reflects generally-accepted civil law concepts of contract and thus provides an acceptable legal framework. It covers quite a wide breadth of topics, including security interests (Section VII-Guarantees) and negotiable instruments (Section XVIII-Promissory Notes, Bills of Exchange and Checks). However, some important commercial concerns--such as securities and bankruptcy--that were covered in the pre-war Commercial Law were omitted during

the 1951 drafting of the Law on Obligations and Contracts because they were not longer considered relevant in a socialist economy.

Currently the aim of Bulgarian lawmakers is to restore the pre-war Commercial Law in full (adding a second book to the new Commercial Law to accompany the first book on companies) and thus create a comprehensive legal framework regulating commercial activity. Only private non-business transactions will then be covered by the existing Law on Obligations and Contracts. Most commercially-oriented sections of the Law on Obligations and Contracts will probably be transferred again (with some updating) to the Commercial Law. Some types of transactions that were introduced in Continental law after World War II, such as leasing and franchising, will be added. Though complex, the task of redrafting and restructuring the law is likely to be accomplished quickly. It will take more time to build experience with the law, enforcement capability and a body of judicial interpretation in the courts, and the strict discipline for contract fulfillment in the population.

### Bankruptcy

#### Historical Background

A working bankruptcy system not only provides a critical "exit" mechanism in a market economy, but it is needed also--along with good collateral and debt collection mechanisms more generally--to discipline borrowers and spur the flow of credit to newly-emerging private sector in Bulgaria and other CEE countries.<sup>64</sup> Bulgaria had a well-developed legal framework for bankruptcy before World War II. It was incorporated in the Commercial Law and was modeled after the French, Italian and Romanian Commercial Codes, but with some original provisions. After being adopted in 1897, the bankruptcy section of the Commercial Law was amended several times, the last time in 1934. Considerable practice and a body of court practice was built before the bankruptcy provisions were abolished with the rest of the Commercial Law in 1951.

These prewar bankruptcy regulations, though comprehensive, suffered from the same problems of other European systems--long and expensive court procedures, low recovery rate, and the availability of loopholes through which the debtor could transfer property before initiation of the proceedings. Bankruptcy was harsh and meant certain closure of the debtor firm; reorganization was not an option in these prewar systems. A Law on Mutual Agreement Procedure ("Concordat") was, however, passed in 1932 to provide an alternative path for insolvent debtors--a framework to negotiate proportional debt reduction with all creditors and thus continue in operation. Similar laws were passed in most CEE countries during the prewar period.

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<sup>64</sup> Bankruptcy is a rather blunt tool that works best "on the margin" in a generally healthy economy. It is not necessarily a good tool to handle the many large loss-making state firms left over from the socialist period, which need instead to be handled together in a coordinated program of privatization, restructuring, and liquidation.

### Bankruptcy Procedures under Decree 56

Bankruptcy as a concept was incompatible with a centrally planned economy. The State, as the sole owner of all commercial assets, supported both debtors and creditors and was ultimately responsible for the relationships between them. With all input, output, and prices set by the plan, enterprise "failure" was not necessarily a cause for closure but rather a cause for restructuring of the enterprise or the plan or both. Indeed, a goal of the system was not to promote competition but to terminate it altogether. Bankruptcy as a concept was forgotten; if mentioned at all, it was as a negative feature of free-market economies.

Along with its many other tasks in connection with the transition to a market economy, Decree 56 of 1989 attempted to reintroduce the concept of bankruptcy. Although still the relevant law in this field, the bankruptcy framework provided by Decree 56 is ill-equipped for the needs of a market economy. It reflects the extensive involvement of the state in enterprise decision making that existed in 1989 when the Decree was adopted. It also reflects a desire to keep insolvent enterprises afloat if possible. Not only does it anticipate state assistance to rescue insolvent enterprises (without setting precise guidelines for such assistance), but it erects barriers to creditor initiation of bankruptcy procedures. First, 60 days of nonpayment is required before a firm is eligible for bankruptcy. Second, before bankruptcy can be initiated, creditors must negotiate with the debtor to try to reach conciliation. Although supposedly limited to one month, such negotiations can be extended. Third, even if such negotiations fail and bankruptcy begins, the court cannot appoint a liquidator and take actions to stop the firm's transactions until the debtor produces a detailed list of its assets and liabilities. These preliminary steps can in practice delay bankruptcy indefinitely, thereby risking even further loss of assets and unnecessarily burdening creditors (particularly in such a highly inflationary environment).

Once bankruptcy begins, a liquidator is appointed to collect the list of claims and liquidate assets to satisfy such claims to the extent possible. Claims are to be satisfied in the following order: wages, tort liabilities, claims of the state, claims secured by lien or mortgage, and unsecured claims. A major barrier to the satisfaction of claims, however, is the extensive limits placed on the sale of certain categories of assets--most notably real estate--used by state enterprises but owned by the state.

The bankruptcy procedures under Decree 56 have only rarely been applied. Not only are they slow and cumbersome, but there is still little incentive to use them. A well-functioning bankruptcy system requires a true conflict of interest between debtors and creditors, and this still does not exist in the state-owned sector. Indeed, it is unlikely ever to exist as long as the bulk of creditors and debtors are owned by the state. For that reason, it can be argued that bankruptcy as known in advanced market economies will only take firm root in transforming socialist economies when the private sector has grown sufficiently to allow an extensive network of links to develop between private debtors and private creditors (whether banks or suppliers).

## The New Draft Bankruptcy Law

Recognizing the shortcomings of Decree 56, the Bulgarians are in the process of preparing a new bankruptcy law. The new draft law closely follows the bankruptcy provisions in the original 1897 Commercial Law. Although a major improvement over Decree 56, the draft law does not reflect some important developments that have occurred in bankruptcy thinking and legislation in industrialized countries over the past 40 years.

First, the law does not allow for reorganization but only for liquidation of a bankrupt firm. Liquidation can be avoided only if the debtor and creditors can negotiate a work-out agreement<sup>65</sup> through which debts are reduced.<sup>66</sup> In contrast, bankruptcy legislation in both the U.S. and Europe has moved in recent years in the direction of reorganization over liquidation.<sup>67</sup> Chapter 11 of the 1978 U.S. law, for example, gives businesses a chance to reorganize, and the reorganization can be converted to liquidation only if creditors establish clear cause. Given the severe disruption likely to result if all inefficient Bulgarian firms are forced to liquidate, Bulgaria could well benefit from a softer approach whereby attempts are made to reorganize a firm before resorting to liquidation. Of course the key is to strike the right--often delicate--balance. Reorganization should not become a means to forestall indefinitely the winding up of clearly unviable enterprises. Many observers, for example, criticize the U.S. approach as too lax, claiming that it gives existing and often ineffective managers too much leeway to avoid liquidation and thus keep inefficient firms in operation, and it ties up too many legal resources in lengthy court procedures. In practice, the great bulk of reorganization cases in the U.S.--especially for small and medium-sized firms--end eventually in liquidation anyway.

Second, the draft law reinforces the negative stigma traditionally attached to bankrupt firms. Not only does bankruptcy (even if caused through negligence) appear to be considered a crime, but conclusion of a bankruptcy case does not appear to rid the debtor of potential claims. Creditors can continue to pursue debt collection even after the debtor's assets have been liquidated, unless creditors and debtors have agreed to a work-out under the mutual agreement procedure. This harsh treatment again contrasts with more recent thinking in many industrialized countries, where bankruptcy laws try to remove the stigma of

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<sup>65</sup> Pre-bankruptcy work-out agreements are governed by a companion law similar to the prewar model, while work-out agreements in the course of bankruptcy are governed by Chapter XI of the bankruptcy law.

<sup>66</sup> The requirements for a post-bankruptcy work-out agreement are themselves quite strict, and thus are likely to discourage debtors and creditors from pursuing this option. In particular, all creditors must agree if the debtor is to satisfy less than 40 percent of outstanding claims. In practice, unsecured creditors rarely recover close to 40 percent in bankruptcy cases around the world.

<sup>67</sup> Most major industrialized countries now have legal frameworks for both reorganization and liquidation, whether contained in one law (as in the U.S.) or in two (as in the U.K. and Japan).

bankruptcy (assuming no criminal intent). Modern laws implicitly recognize that the very essence of capitalism is risk-taking. Some ventures are certain to fail, and the economy gains if those who lose through risk taking are allowed a "fresh start" free from past burdens and stigma.

Finally, the draft gives a central role in administering a bankruptcy proceeding to the judge.<sup>68</sup> Given the shortage of capacity in the Bulgarian court system and the burgeoning number of cases likely to arise in the future, the Bulgarians should be careful to conserve scarce judicial resources. In this regard more of the burden of administration could fall to the trustee, and more decisions could be made without requiring meetings and approvals.

### Related Issues

Bankruptcy is only one part of the larger framework for debt collection that makes private credit feasible in a market economy. Other parts of that framework will also have to be addressed if Bulgaria is to develop a well-functioning credit system. For example, the system for registering security interests should be updated and broadened to include all types of property under all forms of ownership. (At present only mortgages on privately-owned real property are reliably registered.) Second, the right to pledge or sell state-owned assets must be clarified, a challenge intertwined with the difficult questions of property ownership addressed earlier. As in other CEE countries, institutions to implement debt foreclosure in general and bankruptcy in particular must be developed. Training and expanding the number of bankruptcy judges and receivers should receive high priority. Important cases involving bankruptcies should be published, as was done before the war, to establish a set of precedents to guide the activities of debtors, creditors, and judges. Finally, credit-rating services, which do not yet exist in Bulgaria, need to be established.

### Competition Law

Because it was one of the most centrally-controlled economies during the socialist period, Bulgaria started its reform process with a highly concentrated industrial structure. To lower the transaction costs involved in implementing a central plan, the socialist government explicitly created large state-owned monopolies that dominated both production and distribution of virtually all goods. During the socialist period the Bulgarian private sector was very small and operated primarily in retail trade and some services.

The structure and dominance of the public sector throughout Central and Eastern Europe is now proving to be an obstacle not only for the development of the private sector, but also for the improvement of the performance of the public sector itself. Large state-owned monopolies are able to impose unfair conditions on private firms, smaller public firms, and consumers. In essence, private firms

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<sup>68</sup> For example, the judge is in charge of attaching the property of the estate, investigating questions concerning the bankrupt or its property, and overseeing the sale of the debtor's property.



are free to thrive only in niches not dominated by the state sector. Because of their power over output and jobs, large state firms act as a powerful lobby to influence government decision making in fiscal, monetary, trade, and other areas. For this reason the breakup and privatization of state monopolies is essential not only to the growth of a private sector but more generally to the development of a stable market economy. Competition law can be an important tool to encourage such breakup and to prevent abusive monopolistic behavior.

On May 2, 1991, the National Assembly passed the Law for the Protection of Competition. The law regulates both monopolies and unfair competition. It establishes broad principles concerning illegal behavior and sets up a specialized office--the Commission for the Protection of Competition<sup>69</sup>--to prosecute cases, with the possibility of appeal to the Sofia City Court. In addition, the law allows individuals, companies, the Competition Commission, or the District Attorney to bring claims under the law directly to district courts.<sup>70</sup> Although the law is quite imprecise and unclear in its wording, it is a useful start in this very difficult area of law.

### Regulation of Monopolies

The antimonopoly section of the law applies exclusively to entities deemed to hold a monopoly position either they have the exclusive legal right to carry on a particular business (for example, the existing tobacco monopoly) or because they account for market share of over 35 percent (Article 3).<sup>71</sup> The creation of monopoly by government (Article 4) or through merger (Article 5) is not forbidden per se but only if it "restricts free competition and/or pricing." On the other hand (and perhaps in contradiction to Article 5), Article 8 bans cartel agreements that would establish explicitly or implicitly a domestic monopoly.

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<sup>69</sup> The Commission for Protection of Competition is independent from the Government. Its 10 members (including the Chairman and Vice-Chairman) are elected by the National Assembly (Article 2).

<sup>70</sup> This joint jurisdiction of both the Commission and the regular courts in competition cases is unusual. Although the same model is followed in the U.S., in many countries a specialized agency has exclusive primary jurisdiction, with courts handling only appeals. Although providing two avenues of redress may promote more vigorous enforcement of the law, it also opens up greater possibility of conflicting interpretations or misapplication of the law--a particular problem given the complexity of the topic.

<sup>71</sup> Setting a minimum size level (as a share of the entire domestic market) that will trigger action under the law helps to save on administrative resources by targeting administrative action on those firms most likely to restrain competition. However, the threshold of 35 percent, like any figure, is arbitrary, and may or may not reflect a dominant position in any particular market. Much depends on the definition of the product (and to what extent close substitutes exist) and the reach of the actual market (including its openness to international competition).

Once a monopoly exists, it is forbidden from misusing its position, and the definition of misuse is extremely broad. Article 7 defines as misuse: (a) restricting the growth of a market or access thereto; (b) applying inequitable standards or contract terms on others, or selling goods and services that are below common quality standards; (d) conditioning a contract on the acceptance by the other party of unrelated terms ("tie-ins"); (e) "resorting to economic constraint to cause other firms to dissolve, split up, merge or transform"; and (f) monopoly pricing above cost for a considerable period of time. Article 8 bans market-sharing agreements among competitors if they restrict competition or harm consumers, and Article 10 prohibits contracts granting exclusive downstream distribution rights. Article 9 allows competitors to adopt unified forms for commercial contracts only if approved by the Competition Commission. These various categories of wrongdoing, though stated in rather unusual terms, presumably could be interpreted to encompass most of the major horizontal and vertical restraints of trade commonly addressed by antimonopoly regulation in industrialized countries. While the law is all-encompassing, it adopts explicitly or implicitly a "rule of reason" approach in most cases, giving virtually unlimited discretion to the antimonopoly office to decide which cases to prosecute. Yet the wording implies that the named practices are prima facie illegal, i.e. that, if charged, the burden of proof lies with the company. Given the imprecise and somewhat confused wording of the law, it is likely to be very difficult to know in practice what is permitted and what is not. Thus there is tremendous scope for misapplication, which would do particular harm if it were to stifle legitimate business practices in the emerging private sector.

If any of these practices are ruled anticompetitive, the Competition Commission has broad powers to nullify relevant government enactments or impose sanctions on offenders. On its recommendation, the Council of Ministers can enforce maximum and/or minimum prices on the monopoly firm. The law does not give the Office the authority to break up a firm in a monopoly position, nor does the office have the authority to review all proposed mergers and acquisitions except those carried out by firms that are already in a monopoly position (Article 6).

Perhaps the biggest problem with the law is inherent to the subject itself; even industrial countries have found it notoriously difficult to differentiate a restraint of trade that reduces efficiency from a legitimate business deal that raises efficiency in the short- or long-run. Sophisticated economic analysis in the U.S. and Europe shows that many vertical restraints (such as tying of sales, resale price maintenance, refusals to deal, discriminatory pricing) may enhance efficiency under certain circumstances--typically when market structure is competitive and the firms imposing the restraints are not in a dominant position. As a result of this economic analysis, enforcement of U.S. antitrust law has softened in the 1980s, and the Department of Justice refuses to prosecute many cases it would have brought in earlier times. The OECD is also recommending that European jurisdictions relax their laws to look at each case on an individual basis (the "rule of reason" approach) rather than forbidding certain practices under all circumstances (the "per se" approach). Opponents of the rule of reason approach argue that businesses need certainty above all, and that the rule of reason approach leaves too much uncertainty as to what is permitted and what is not, and therefore inhibits business activity.

Interpreting and applying the new Bulgarian law effectively is an enormous

challenge, particularly given the lack of clarity in the law itself and the broader set of problems with antimonopoly legislation in general. The enforcement office will need to tread lightly at first. As well as handling individual complaints, it should concentrate on its other important missions: educating the public about the distortions caused by monopoly behavior and lobbying the government and Parliament to minimize barriers to international trade--the most powerful antimonopoly force of all. Given the importance of industrial structure in determining monopoly behavior, the office should also be given a mandate to review privatization proposals (as is done in Poland) to try to stop public monopolies from becoming private ones.

#### Regulation of Unfair Competition

Chapter 4 of the Law bans unfair competition, defined at length in Article 12. Although the definition is very broad, specific examples focus primarily on misinformation--whether misleading advertising, concealment of deficiencies in products, circulation of false facts about competitors, or misuse of trademarks or brand names. Also banned more generally is "non-compliance with ... a contract...aimed at concluding a similar contract with a third party", if it hurts the competitive position of the original counterpart. As with antimonopoly regulation, the Bulgarians must be careful not to be too overzealous in applying these restrictions, lest they stifle reasonable competitive behavior.

#### Judicial Institutions

The implementation of the new set of business-related laws discussed above will be the greatest challenge facing the judicial system in Bulgaria in the next few years. The lack of judicial experience, if not dealt with adequately through technical assistance and training, could prove to be a serious obstacle to market reforms.

#### The Court System

Under socialism the judicial system was not independent but was supposed to serve the goals of the state. Although central control over the judicial system relaxed somewhat in the mid- and late 1980s, local communist party committees continued to have decisive influence over the appointment and promotion of judges. Judges in courts of first instance had greater independence than those in higher positions.

Courts in Bulgaria were not involved in commercial cases during socialist times. The private sector was almost non-existent, and disputes between state enterprises were dealt with in specialized state arbitration boards under the Council of Ministers. These boards have been dissolved, and most arbitrators have joined newly-created commercial sections of regular courts. Unfortunately, the experience gained by these arbitrators--primarily oriented to implementing the central plan--has little relevance today. Not only is the subject matter of future commercial litigation likely to differ markedly, but legal procedures are likely to differ as well. In the past enterprises had little incentive to win a case, and little outside evidence was ever used to resolve disputes. Modern principles and techniques of litigation were virtually nonexistent.

The Bulgarian court system is still organized according to the provisions of the Constitution of 1971, although it will soon be reorganized to comply with the new Constitution. The highest judicial body is the Supreme Court, which used to be elected by the National Assembly. It has three chambers-Civilian, Criminal and Military. Its important decisions are published and widely used by practicing lawyers as references. Below the Supreme Court are the District courts, and below them are the Regional (general) courts. District courts have appellate jurisdiction in matters covered by the regional courts, and original jurisdiction in certain cases. Time and training is needed at all levels of the court system to develop the capacity and experience to handle the plethora of new commercial issues emerging as the economy moves toward a market system.

Arbitration could be a useful alternative to court procedures as a means to resolve commercial disputes among private parties. As in other CEE countries, the Bulgarian Chamber of Commerce and Industry has an arbitration commission that specialized during the socialist period in the settlement of international trade disputes. A broader mandate and proper technical support could help this body develop into a viable alternative means for dispute resolution. The legal basis for private arbitration between domestic parties is unclear. Although the Code of Civil Procedure (Article 9) restricts private arbitration to disputes between Bulgarian and foreign persons, Decree 56 (Article 98) explicitly allows private arbitration between domestic parties if both parties agree in writing. How a decision reached pursuant to Decree 56 would be executed is, however, unclear.

#### Lawyers

As in other CEE countries, the Bulgarian legal profession was divided into two branches during the socialist period--lawyers belonging to a bar association (advocates) and legal advisers within state enterprises (jurisconsults). The jurisconsults handled virtually all commercially-related legal work, while lawyers were not generally involved in commercial areas. There is now somewhat of a tug-of-war between these two groups as to who is the more qualified to emerge as the private commercial lawyer of tomorrow.

Setting up private commercial law practice has been allowed in Bulgaria since 1989, and it is indeed beginning on a modest scale. However, it is still subject to certain regulations carried over from the previous regime. For example, persons with legal training may not appear in court if they are not employed by particular enterprises as "jurisconsults" or are not members of a particular bar association. Passage of the bar examination, required of all legal practitioners, is not synonymous with membership in the bar, which until recently was regulated by the state. Thus, some of the new legal firms have both "solicitors" with commercial experience and advocates hired primarily because they can appear in court. On the other hand, many legal and ethical issues surrounding the practice of law in industrial economies--such as liability for advice given, confidentiality, and conflicts of interest--have not yet been addressed.

#### Conclusion

The Bulgarian government is working steadily to create a legal framework

in which the private sector can develop. Many new laws--including a new Constitution and new laws on companies, foreign investment, and competition--have been adopted over the past 2 years, and more are now being drafted and debated. Bulgaria's pre-war legal framework was quite modern for its time, and most of these new laws draw on pre-war Bulgarian tradition.

However, the administrative and judicial machinery for implementing those laws is slower to develop. Laws by themselves are only paper; the legal framework will "come to life" only when the legal and administrative institutions can enforce the laws and readily resolve the disputes that they inevitably spur, and when the public accepts that the laws are indeed binding. Furthermore, the laws are by necessity general frameworks only. Their content needs to be filled in by more detailed regulations and practice in individual cases, a process which by necessity takes time. The challenge of legal development is as immense as that of economic reform, and the two are inexorably intertwined.

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